S. HRG. 99-322

NOMINATION OF EDWARD H. FLEISCHMAN

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

THE NOMINATION OF EDWARD H. FLEISCHMAN, OF NEW JERSEY, TO BE A MEMBER OF THE SECURITIES AND EXCHANGE COMMISSION FOR THE REMAINDER OF THE TERM EXPIRING JUNE 5, 1987, VICE JAMES C. TREADWAY, JR., RESIGNED

NOVEMBER 14, 1985

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NOMINATION OF EDWARD H. FLEISCHMAN TO BE A MEMBER OF THE SECURITIES AND EXCHANGE COMMISSION

THURSDAY, NOVEMBER 14, 1985

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Heinz, Armstrong, D'Amato, Gorton, Mattingly, Hecht, Gramm, Proxmire, Cranston, Riegle, Sarbanes, Dixon, and Sasser.

Also present: Congresswoman Roukema.

OPENING REMARKS OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

The purpose of this morning's hearing is to consider the nomination of Edward Fleischman to be a member of the Securities and Exchange Commission.

Mr. Fleischman, we would like to have you come up to the table and we are pleased, Congresswoman Roukema, to have you introduce him. Please proceed with your introduction at this time.

STATEMENT OF MARGE ROUKEMA, U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mrs. ROUKEMA. Thank you.

Mr. Chairman and members of the Banking Committee, it is a distinct pleasure and an honor for me to be here today to introduce to you my constituent, Mr. Edward Fleischman, who has been selected for this appointment.

We in New Jersey are not only proud of New Jersey but we are proud of the Fifth Congressional District of New Jersey because we have a number of distinguished citizens and certainly Mr. Edward Fleischman is one of them.

I can't claim to have any longstanding association with Mr. Fleischman. Although he is a constituent, we have not known each other well over the years. However, when I learned of his potential nomination, I did my homework. We have a large constituency in Bergen County, northern New Jersey, of those people who are identified with the securities industry, have positions of prominence on the street, and so I felt that it was incumbent upon me to make appropriate inquiries and I did.

I inquired extensively and I found to my great pleasure that Mr. Fleischman was not only well known among his colleagues but also was known as a person of high distinction, of great excellence, and had a career of long standing.

Mr. Fleischman has served effectively in the practice of securities law for more than two decades. He has served with distinction on several committees, committees of the bar, including the committee on Federal regulation of securities.

It is an honor for me to join the President in what I think has been an outstanding decision and judgment in the selection of Mr. Fleischman.

I commend him to you without reservation. I am sure that he will serve with the same distinction that has marked his career on the Securities and Exchange Commission.

Thank you very much, Mr. Chairman, and now I'd like to present to you Mr. Edward Fleischman.

The CHAIRMAN. Thank you very much. We appreciate you taking your time to come and introduce Mr. Fleischman.

I also would ask unanimous consent that a statement of support by Senator Frank Lautenberg be included in the record. He was not able to be here this morning. As a result of the opening of the Senate he was introducing the guest chaplain to give the prayer that is undoubtedly going on right at this moment.

I also have statements by Senators Heinz, Cranston, and Dixon, all to be included in the record.

[Complete statements of Senators Lautenberg, Heinz, Cranston, and Dixon follow:]

STATEMENT OF SENATOR FRANK R. LAUTENBERG

Senator LAUTENBERG. Mr. Chairman, it is a pleasure to be back in this hearing room. I miss the work of the Banking Committee, and the important issues on its agenda.

I appear before you today to introduce to the committee Mr. Edward Fleischman, who has been nominated to fill the remaining vacancy on the Securities and Exchange Commission.

Mr. Fleischman is an able, well-respected securities lawyer. He has practiced law with the Wall Street firm of Beekman & Bogue, and then Gaston, Snow, Beekman & Bogue for over 25 years.

He has been an adjunct professor in securities regulation at New York University Law School, and has lectured and written on the subject. He has participated in a variety of ABA committee activities, in an effort to assist practitioners and to improve the law in the area of securities regulation.

He will bring to the Commission experience, intelligence, and wisdom.

Certainly, there are substantial issues that will come before the SEC during Mr. Fleischman's term, if confirmed. It is my understanding that a comprehensive review of some of the issues involved in the area of takeovers and tender offers has awaited bringing the Commission up to full strength.

I think Mr. Fleischman will make a major contribution to the Commission's effort.

I recommend him to you, and urge the committee to report his nomination promptly to the full Senate.

STATEMENT OF SENATOR JOHN HEINZ

Senator HEINZ. Thank you, Mr. Chairman, and welcome, Mr. Fleischman.

You have impressive credentials for the job for which you have been nominated. The knowledge and practical experience you have gained through 26 years of practicing securities law is invaluable preparation for this position.

In the upcoming months, you will be asked to make decisions on a myriad of issues. Your decisions could have very serious consequences on the health and safety of businesses in our Nation.

Whether or not action should be taken to change the execution of hostile takeovers is a question that is facing the Congress today. An impressive number of people believe that no action would be needed if only the Securities and Exchange Commission would do the job they have been charged with performing: Disclosing accurate information on securities transactions to the public. I would be interested in hearing your views on whether schedule 13D filings, for example, are being honestly completed and are being adequately monitored. Are we getting the information we need from that filing?

I am also interested in hearing whether you believe the SEC is adequately staffed to enforce the laws we have passed and the regulations the SEC has promulgated? The SEC's staff has been reduced considerably in recent years. Although I support efforts to reduce Government spending, I do not support them if the result is the inability to perform mandated responsibilities.

This is a fascinating and stimulating time to be involved in securities law. I am most pleased that we can anticipate guidance on the complicated and sometimes esoteric issues facing the SEC from you, an experienced and informed master of the game.

STATEMENT OF SENATOR ALAN CRANSTON

Senator CRANSTON. I would like to welcome Edward Fleishman before the Senate Banking Committee. I am very pleased with the President's nomination because of the nominee's extensive background in the legal aspects of the securities law.

This nomination comes at a time when the Securities and Exchange Commission [SEC] seems to be at a crossroad. There are serious complaints around that the SEC is understaffed and underbudgeted and that investors are more exposed to questionable investment information, without adequate review, than ever before. In fact these complaints arise at a time when the securities industry is undergoing a period of explosive expansion. The average daily volume on the New York Stock Exchange has jumped from 32 million shares to 91 million shares over the last 5 years. During this period the SEC's staff has been cut by 5 percent.

The SEC directly oversees 10 stock exchanges, 10,000 broker-dealer firms, 2,000 investment companies, 9,000 investment advisers, and 13 public utility holding companies to ensure their compliance with the law.

Indeed a recent article in Money magazine's November 1985 issue reviews many of the marketplace and regulatory problems I have mentioned. The article is entitled: "The Leaky Umbrella That is the SEC."

I refer you to that article so you can see what you are getting into.

I know that you will bring a wealth of expertise and temperence to these problems and put the resources of the SEC at work to reconcile these issue to protect the national interest.

I ask that this article be printed in the record.

[The article submitted by Senator Cranston follows:]

BONUS

THE LEAKY THAT IS

DELUGED BY DUBIOUS SECURITIES, INVESTORS ARE NOT GETTING MUCH RELIEF FROM WASHINGTON.

by Gretchen Morgenson

Financial markets today are awash in more troubles than they have had at any time since 1929. In the past five years, eight government securities firms have failed; in the past 24 months, 20 savings and loans have closed their doors; this year alone, 81 commercial banks have been declared insolvent, more failures than the U.S. has seen since the Depression. Six small brokerage firms have folded just since spring. Heavy trading in new and complex financial instruments such as stock index options regularly jolts the stock market, causing prices to twitch up 11 points one day, down 11 the next.

Given that sorry history, one might expect the government agency charged with policing the investment world, the Securities and Exchange Commission, to stand ever more watchfully over such frenzied and perilous markets. Unfortunately, that is not the case. Individual investors are now at greater risk of losing their money through fraud than at any time in the past 50 years. Says Herbert Milstein, chief SEC enforcement attorney in 1970: "Chaos in the financial markets is the story of the 1980s. When we look back on this decade, we'll be asking ourselves, 'Where were the regulators?' "

The regulators are there, of course, as they have been since the SEC was created by Congress in 1934 with its mandate to protect investors against fraudulent public offerings and high-pressure salesmanship. The problem is that, both by design and circumstance, the agency is either unable or unwilling to carry out its mandate. Consider:

- The SEC is critically underbudgeted and understaffed.
- Only a small fraction of the corporate filings required by law are ever given a thorough inspection.
- Individual investors are more exposed to questionable investments but are getting less information to evaluate them.
- Churning, the excessive trading of individual accounts by brokers to generate commissions, is more widespread than ever before.

As a result, the SEC is far from the body that was envisioned by its founders or that investors need today.

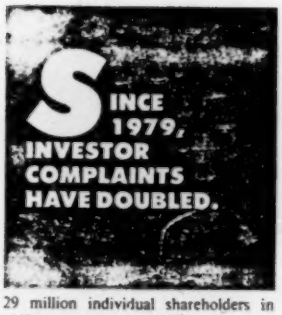
The SEC's agenda is currently set by its chairman, John S.R. Shad, 62, former vice chairman of E.F. Hutton Group in New York City and chairman of Ronald Reagan's 1980 New York State campaign finance committee. As far as individual investors are concerned, Shad's record is mixed. During his four years as head of the commission, he has made some highly visible policy changes that have increased investor protection. The SEC has vigorously pursued insider trading cases and fraudulent corporate accounting. Tackling these two market abuses helps all investors by preventing groups of shareholders from profiting illegally at the expense of others.

But Shad has taken other actions that have actually left individuals less informed about securities offerings and more vulnerable to potential swindles. In addition, the agency is no longer as interested as it once was in safeguarding investors from the aggressive sales tactics of stockbrokers. According to one commission official, a six-year veteran who requested anonymity: "There has been a real shift in priorities. There is less emphasis now on investigating unauthorized trading, churning and financial-reporting fraud than there was five years ago."

This shift in emphasis comes at a time when the securities industry is undergoing a period of explosive expansion. (For the exact dimensions, see the table on page 228.) In the past five years, the number of new investment companies registering with the SEC annually has tripled, to 256, and registrations of initial public stock offerings have more than doubled, to 1,761 last year. Applications to form new broker-dealer firms have increased 101%. The average daily volume on the New York Stock Exchange has jumped from 32 million shares to 91 million shares, and stockbrokers now number 78,000, up from 52,000 in 1979. Even the investing population has grown, from

UMBRELLA THE SEC

ILLUSTRATION BY MICHAEL WITTE



29 million individual shareholders in 1979 to 42 million in 1983.

During the same five-year period, the SEC has shrunk. To streamline his agency, Shad has cut staff 5%. Lawyers in the enforcement division, the agency's muscle, now number just 310—about the size of a large law firm. The SEC will operate on a budget of around $100 million this year—less than the amount that Merrill Lynch spends annually on postage and office supplies. Although the SEC's budget is allocated by Congress, the agency reimburses the Treasury out of the fees it collects. Last year Shad actually returned $26.9 million more to the Treasury than his budget allocation.

Some people might praise the chairman's frugal management. But Democratic Representative John D. Dingell, chairman of the House Energy and Commerce Committee that oversees the commission, argues: "I'd rather the SEC used these leftover funds to step up its policing of the securities markets."

This disparity between growing markets and the shrinking SEC workforce worries Dingell as well as many securities lawyers and state securities regulators. According to a 1985 General Accounting Office study, "securities law violations are directly proportional to the size and activity of the financial markets." In fact, investor complaints and inquiries to the SEC about mutual funds, issuers of securities and broker-dealers have doubled in the past five years to 30,000 annually. Says Dingell: "The perception of a soft SEC increases risk in the securities markets because big money attracts big rascals."

Since its founding, the SEC has patrolled its beat with more or less vigor, depending upon who is in the White House and who the chairman is. But its areas of jurisdiction have remained unchanged:

Regulation of the securities industry. The SEC expects stock exchanges and securities dealers' associations to supervise individual brokers and other professionals. But the agency also directly oversees the 10 stock exchanges, 10,000 broker-dealer firms, 2,000 investment companies, 9,000 investment advisers and 13 public utility holding companies to ensure that they comply with securities laws. For example, the SEC recently charged Kidder Peabody, a New York City brokerage, with mishandling $145 million of its customers' securities. The SEC accused the firm of using the securities as collateral for its own bank loans and government securities trading, a violation of securities laws. Kidder said it didn't break any rules.

Enforcement of the rules of full disclosure. Under federal securities laws, any company that wants to sell its securities to the public must submit to the SEC and interested investors complete details of its financial and business operations. They must also update this material quarterly and annually. The SEC does not rule on whether the securities represent a good investment or if the offering is fair to investors; it merely ensures that all the

In five years, the securities markets have boomed . . .

	1979	1984	% change
NYSE daily share volume	32 million	91 million	+184
Number of stockbrokers	52,000	78,000	+50
New broker-dealer applications	1,379	2,769	+101
New companies registered under Investment Company Act	83	256	+208
Registrations of initial public offerings of stock	684	1,761	+157
Customer complaints and inquiries to SEC	15,000	30,000	+100
Investor cases brought to securities dealers for arbitration	185	781	+322

. . . but SEC staffing and enforcement have lagged

	1979	1984	% change
Number of lawyers employed by SEC	733	685	–6
Number of accountants employed by SEC	127	120	–5
Investigations of possible violations of securities acts	296	341	+15
Injunctive actions	108	179	+65
(defendents named in them)	(511)	(508)	–0.5
Administrative proceedings	81	114	+41
Number of criminal indictments obtained by the U.S. Justice Department	42	61	+45
Enforcement division funding	$23 million	$31 million	+35

relevant facts have been made public. (See the box on page 234 for ways that you can test a security's fairness.)

You might hope that to ensure compliance with the laws of full disclosure, SEC staffers would scrutinize most of the 67,466 prospectuses, proxy statements, annual reports and limited partnership registrations that were filed last year. Unfortunately, about 200 lawyers, accountants and financial analysts in the commission's division of corporation finance were able to examine only 10.3% of them in depth.

Suppression of fraud. The lawyers in the agency's enforcement division investigate companies charged with violations of disclosure rules and broker-dealers accused of illegal securities trading. The charges are aired in administrative hearings or in civil suits before the federal district courts. The commission can also refer cases to the Justice Department for criminal prosecution. The agency settles most of its cases by consent decree, in which the accused party neither admits nor denies any wrongdoing. But it can force offenders to give up any illegal profits to the U.S. Treasury.

Much of what the SEC does and doesn't do can be attributed to Chairman John Shad's fervent belief—shared by President Reagan—that business works best when it is regulated least by the government. When Shad took over, he said he had three goals: "To increase investor protection, to reduce unnecessary paperwork and other expenses borne ultimately by investors and to increase corporations' financing flexibility." Two years ago, in a speech before a group of stockbrokers, Shad lightheartedly defined "a damn shame" as "a busload of government officials going off a cliff—with five empty seats." (Despite repeated requests, Shad declined to be interviewed in person or to answer questions submitted in writing; his comments cited here have come from his spokesman and from speeches.)

Shad's desire to cut back on regulation has been welcomed by the securities industry. He is only the third SEC chairman to come from Wall Street; the best known was Joseph P. Kennedy in 1934. Securities lawyers and state securities regulators, however, argue that today's skittish markets require more—not less—government watchfulness. Complains Michael F. Barrett Jr., chief counsel to the House subcommittee that monitors the SEC: "The agency could take a leadership position in the marketplace. But the recent move to deregulation is a justification for its doing nothing."

The agency's current aggressive stance against insider trading—in which stocks or options are traded on the basis of nonpublic information and then cashed in when the news is announced—reflects Shad's leading priorities in the area of investor protection. In the past three years, the commission has brought 57 insider trading cases to trial, almost half as many as had been prosecuted in the preceding 32 years. Two of the most famous defendants, Paul Thayer, a former Deputy Secretary of Defense in the Reagan Administration, and R. Foster Winans, a former Wall Street Journal reporter, were given prison terms.

Another top enforcement priority is halting misleading corporate accounting practices. For example, earlier this year the SEC forced Burroughs Corp. to restate its earnings for both 1981 and 1982. The agency charged that by listing $154 million worth of obsolete inventory among its assets, the Detroit-based computer manufacturer had overstated its earnings by some $60 million in those two years. Explains SEC enforcement chief Gary Lynch: "Requiring a company to restate its earnings is a way of alerting investors to problematic financial statements."

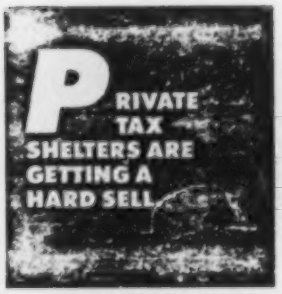
Chairman Shad on the rostrum

But Shad's goal of increasing investor protection is partly undercut by his two other goals: reducing unnecessary paperwork and increasing corporations' financing flexibility. In 1982, for instance, the agency eliminated the requirement that a public corporation disclose in proxy statements whether a company director is also a director of one of its significant customers, creditors or suppliers. These conflicts of interest can lead to management decisions that are bad for the company and its shareholders.

Since 1983 the SEC has no longer required mutual fund prospectuses to include such details as: fees paid to directors and officers of the fund; crucial information such as whether the fund is emerging from bankruptcy with a new name but under the same management; the amount of commissions paid to brokers to sell fund shares; and the specific methods that the managers may use to achieve their investment objectives—for example, selling stock short or trading options. The commission concluded that "such information is not necessary or appropriate for the protection of investors."

As is often the case, certain states may pick up the slack and require more information from mutual fund companies. But for now you must write the fund to ask how much money is being invested vs. how much is paid out in broker commissions or as fees to directors. The fund is then obliged by the SEC to send you a so-called statement of additional information containing the details. Says Ulice Payne Jr., Wisconsin's state securities commissioner: "There hasn't been a mutual fund disaster yet, but I am concerned about the impact of reduced disclosure."

Shad's SEC has also made it easier for issuers to raise money in often-risky unregulated and unregistered private placements, more than 90% of which are tax shelters. Sponsors of private deals that put partners' money in, say, oil wells or real estate, have never been required to register with the SEC and abide by its full disclosure rules as long as they were raising less than $100,000 or limiting their offerings to 35 or fewer sophisticated investors. (The SEC defines sophisticated



investors as individuals who know enough about investing to recognize and assess an offering's risks and who can afford to lose all the money they put into it.)

But in 1982 the SEC increased the minimum to $500,000 and now allows private deals to be offered to any number of sophisticated investors. As a result, private partnerships will raise an estimated $25 billion this year, up from just $6 billion five years ago, without any vetting by the SEC. Complains Michael Unger, director of the securities division of the Massachusetts Secretary of State: "These changes have opened the door to more abusive tax shelters." And Mary E.T. Beach, associate director of the SEC corporation finance department, asserts: "I suspect that there are more investors getting into these private placements today than ever before."

What many of these eager investors don't realize is that they are on their own in evaluating private placements. No federal regulator reviews the accuracy of the offering's projected rates of return, for example. Moreover, private shelters are getting a hard sell by stockbrokers nationwide, increasing the opportunities for abuse. Says David Lipton, professor at Catholic University of America School of Law in Washington, D.C. and an arbitrator of disputes between disgruntled investors and their brokers: "Not surprisingly, the greatest number of complaints that I see alleging broker misrepresentation of facts involve private-placement tax shelters. There are numerous instances of brokers who overstate the returns on these offerings, even going so far as to call them no-risk."

To help some corporations raise money more easily in the public market, the SEC in 1982 promulgated what quickly became known as shelf registration. Most companies must file a prospectus with the SEC each time they want to sell shares or bonds to the public, no matter how often that is. But shelf registration permits certain well-established corporations who have been filing statements with the SEC for three years to file once with the SEC and then sell the securities as often as they wish over the next two years.

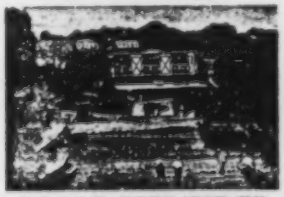
The securities can lie on the shelf until the market for them improves, giving the issuer a better price. But two-year-old financial information may be out of date by the time the securities are issued, leaving investors ignorant about a company's true financial condition. Before leaving Wall Street to become Deputy Secretary of State, John C. Whitehead, then co-chairman at Goldman Sachs, warned: "When the market goes down, we will all regret that we so facilitated public offerings that investors didn't get adequate or timely information on what they were being asked to buy."

Shelf registration also permits institu-

Reporter associates: Leslie Vreeland

"VARI

BEST WESTERN AND AMERICAN



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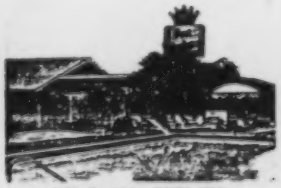

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tional investors to buy securities directly from an issuer, cutting out small investors who might be interested in the offering. In a recent 10-day period, institutions bought the entire stock offerings of two insurance companies. Small investors never got a crack at either one. Says Toby J. Petersen, a vice president at Dain Bosworth, a Minneapolis regional brokerage: "Individual investors have fewer chances to buy newly issued securities today. It's just another example of the institutionalization of the capital markets."

Deregulation aside, the SEC under Shad has been slow in reacting to persistent questionable practices by stock brokerages. In December 1984, for example, the SEC charged that E.F. Hutton had been defrauding its mutual fund customers from December 1981 through February 1983. (Shad has excused himself from participating in any matter related to his former firm that comes before the SEC.) Hutton had been advising customers to mail their payments for shares within five business days, the normal procedure for securities purchases. But, according to the agency, rather than investing the clients' money in the funds immediately, as Hutton had promised in its prospectus to do, it held on to the cash until the end of the five-day period and then invested it. During this time, the firm earned about $191,000 in interest on the money.

The SEC considered Hutton's use of the float to be a violation of securities laws. It censured Hutton and forced the firm to credit the interest it earned against its mutual fund advisory fee, effectively returning the $191,000 to the fund's shareholders. For its part, Hutton settled the charge without admitting or denying guilt.

Just five months later, E.F. Hutton admitted to playing a different float. The firm regularly overdrew its accounts at banks, thereby profiting from the use of funds that the banks had not yet collected. The Justice Department fined Hutton $2 million, forced it to pay $750,000 in court costs and required the firm to set aside funds to pay back the banks.

Under the Investment Company Act of 1940, any firm convicted of a felony or misdemeanor in connection with its business as a broker-dealer is automatically disqualified from selling mutual funds. But the SEC granted Hutton a 180-day exemption from the law in exchange for its full cooperation with the investigation into the check kiting. Explains Kathryn McGrath, the director of investment management at the SEC: "It would be irresponsible to disrupt Hutton, its shareholders and its employees while the SEC reaches a final decision on the matter."

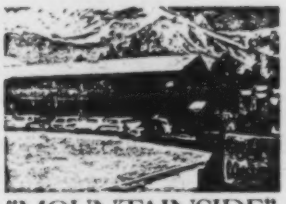
Full and accurate disclosure of a firm's business and financial data is at the heart of the SEC's mandate. But if an investor thinks that a company made false or misleading statements in a prospectus or annual report, he is likely to find that the current commission has little interest in helping him prove fraud in court. The SEC contends that it is not a collection agency for disgruntled investors.

Indeed not. For instance, the SEC didn't get around to charging Saxon Industries and three of its former executives with falsifying company records and inflating inventories until four months after investors sued. Likewise, St. Paul computer software maker Comserv was not charged by the SEC with inflating its earnings until almost a year after a group of investors brought suit.

The problem of churning in many ways epitomizes the hands-off attitude of

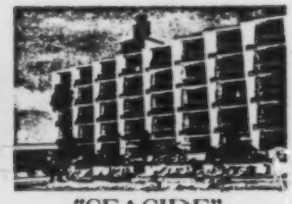
ETY"

EXPRESS. YOU'VE GOT OUR WORD.



"MOUNTAINSIDE"

With over 2,000 properties in this country, you can bet that if there are views, there are Best Westerns overlooking them. So when you want to take in the scenery, take in a Best Western. Like the Best Western migan Lodge in Dillon, Colorado, for a breathtaking view of the Rockies.



"SEASIDE"

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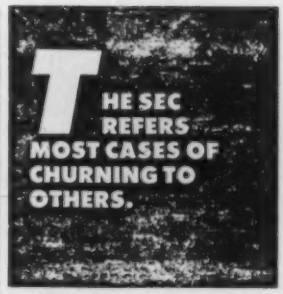

the SEC toward investor complaints. Churning has been around as long as brokers have been rewarded for trading volume, but lately it has been on the rise. Says Robert Shabazian, an assistant vice president of the American Stock Exchange: "Based on our compliance department's investigations over the past three years, there has been an increase in churning." Donald Malawsky, senior vice president of enforcement at the New York Stock Exchange, notes: "Unauthorized trading in customers' accounts is way up from five years ago." But the SEC, by the admission of the New York office's regional administrator, Ira Sorkin, has taken a less active role in prosecuting cases in the past two or three years. Instead, it refers most of them to the stock exchanges and broker-dealer associations because it doesn't have the staff to scrutinize millions of daily trades.

Unfortunately, letting brokers regulate other brokers creates tremendous conflicts of interest. The exchanges and the National Association of Securities Dealers, which regulates the over-the-counter market, can indeed spot churning by conducting surprise audits of randomly selected brokers' client books to look for suspicious trades. But the exchanges are private concerns owned by individuals and member firms, many of whom are brokerages. That makes it difficult for the exchanges to enforce anti-churning rules as vigorously as they might. According to Norman Poser, a professor at Brooklyn Law School and former executive vice president at the American Stock Exchange: "There's no doubt about the conflict facing the exchanges when they are supposed to discipline member firms. On the whole, the exchanges' records have been spotty."

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▸ Insider holdings. Large amounts of so-called cheap stock sold to officers or directors of a company before the offering effectively reduce the value of the shares held by the public because insiders wind up owning proportionately more of the company although they have invested less money.

▸ Voting rights. All common stock should have the same voting rights, but stock held by insiders is sometimes given greater weight. If public shareholders have less clout, they should be compensated by, say, the right to tender their shares first in a takeover.

▸ Underwriting fees. If selling the securities costs the issuer 10% or more of the proceeds, that may be a sign that the underwriter thinks the offering is risky and wants to be paid accordingly.

▸ Low-interest loans to officers. Any personal loans made to corporate officers whose shares will be sold as part of the offering should be repaid from the proceeds.

▸ Conflicts of interest. Relationships between management and the firm's suppliers must be at arm's length. The chief purchasing agent shouldn't pay more to buy paper clips from a director's firm, for instance.

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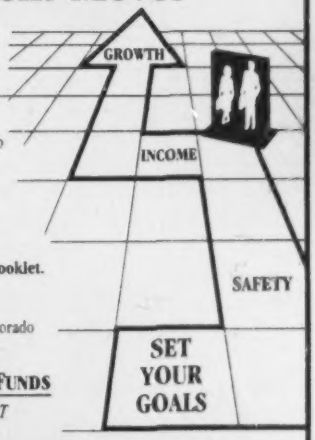

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churning by their own employees. This creates a second conflict because the commission system of paying brokers encourages them to trade frequently. Says Arthur Schwartzstein, a securities lawyer in Washington, D.C. who was an enforcement attorney at the SEC for three years: "As long as brokerages reward their salespeople for nonstop trading, individual investors' portfolios will be at risk." Indeed, despite the steep increase in overall trading activity, there has been a decline in disciplinary actions taken by the exchanges against brokerages and their employees. In 1984 there were 394 such actions as opposed to 475 in 1983 and 407 in 1980.

Some especially egregious examples of churning go publicly unnoticed and unpunished. According to a lawsuit brought by private investor Janet Hoey, 54, of Tampa, she was defrauded out of more than half of her $1 million stock and bond portfolio in three years. During that time, her Smith Barney broker made 389 trades, generating about $500,000 in commissions for himself and his firm. Hoey sued the brokerage firm, charging that it didn't adequately supervise her broker. She ultimately settled out of court on the advice of her lawyers for slightly less than her losses.

The SEC took no action against the broker or against Smith Barney, even though Hoey's lawsuit claimed that the firm's lax supervision violated federal securities laws. According to Hoey's lawyer, none of the exchanges involved took any action against Smith Barney. As for the SEC, New York administrator Sorkin explains: "We will not generally pursue a single broker unless he repeatedly causes problems over a period of years or with a number of customers; that is, unless he's a recidivist." Says a disgruntled Hoey: "I figured that someone somewhere kept a watchful eye on stockbrokers' activities. I was wrong." $

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the committee considers the nomination of Edward Fleischman to be a member of the Securities and Exchange Commission.

Great changes are underway in the financial services industry. The lines between banking and securities are becoming increasingly blurred. Both banks and securities firms are each moving into areas that were traditionally considered the province of the other.

The Securities and Exchange Commission is faced with a real challenge in responding to the changing marketplace realities. The Commission is also one of the key experts on which Congress relies as we attempt to modernize and reform the Federal financial services statutes.

Congress is also currently considering reforms in the takeover area, particularly tender offer transactions. I am rather concerned about the increasing number of takeovers, and what they mean for U.S. corporations and the competitive posture of our economy. While I understand that takeovers do impose a kind of discipline on corporate managers, it seems to me that this tool can be used excessively, and that it sometimes results in forcing managers to concentrate on short-term earnings, rather than long-term growth and competitiveness. Further, takeovers can hurt corporate balance sheets, giving them more debt than is healthy or desirable. Finally, tender offers often help some shareholders, but not all. Not all shareholders are able to take advantage of tender offers, and this raises real equity questions.

I look forward to hearing from the nominee on these issues and other major issues facing the SEC.

The CHAIRMAN. Mr. Fleischman, before we begin may I have you stand to be sworn?

[Whereupon, the witness was duly sworn.]

The CHAIRMAN. Do any of the committee members have an opening statement that they wish to make?

Senator D'AMATO. Mr. Chairman, I have a statement that I would ask that it be included into the record as if given in its entirety and simply say that during this time when the SEC is taking on increasingly complex matters it's certainly heartening to see the caliber of the recommendation with the breadth and length of service that Mr. Fleischman has given as one of the outstanding securities attorneys in New York. I commend his nomination and I look forward to working with him in the future.

The CHAIRMAN. Thank you very much, Senator.

[Complete statement of Senator D'Amato follows:]

STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. I am pleased to introduce to the Banking Committee the nominee to the position of Securities and Exchange Commissioner, Edward Fleischman. Although Ed Fleischman is not a resident of New York, I endorse him because he has been an ourtstanding member of the New York legal community for many years. His academic and legal accomplishments qualify him to serve as a member of the Securities and Exchange Commission.

He is a graduate of Harvard College and Columbia Law School, and he has had a securities law practice in New York City for 26 years. As a member of the bar he has actively participated in the committees on Federal regulation of securities, developments in business financings, and counsel responsibility and liability, as well as a number of others. He has been an adjunct professor in securities regulation at New York University Law School for 10 years, and is a frequent lecturer at seminars dealing with securities and future law and practice.

The SEC is faced with increasingly complex regulatory issues, and the decisions made by the Commission are vitally important to our Nation's economic well-being. I am heartened that someone with the knowledge, experience, and expertise of Ed Fleischman has been nominated to serve on the Commission. We are fortunate to have an individual of Ed's caliber make a commitment to public service. I look forward to his confirmation and to his future appearances before the Securities Subcommittee.

The CHAIRMAN. Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman. I'm also equally happy that a man of his background is going to leave private industry and come to work for the Government. We need more people like him and I'm looking forward to working with him.

The CHAIRMAN. Thank you.

Mr. Fleischman, you can be complimented by the fact that so many of the committee members left because if you were controversial or had major problems that's when we have a full committee. So if they had stayed, you may have some worry. But I hope you understand we are in an unusually difficult period in the Senate right now with many committee meetings going on. Senator Dixon had Secretary Weinberger before the Armed Services Committee. I feel badly about that sometimes and those who are not familiar with the Congress don't often understand, but I did want you to know that they do have other responsibilities and are not just leaving so that they're not here.

We do appreciate your being here. Do you have an opening statement you wish to make?

STATEMENT OF EDWARD H. FLEISCHMAN, NOMINATED TO BE A MEMBER OF THE SECURITIES AND EXCHANGE COMMISSION

Mr. FLEISCHMAN. Mr. Chairman, to appear before this distinguished committee as the President's nominee for a position as a member of the Securities and Exchange Commission is a privilege of which I am truly proud.

Since admission to the bar more than 25 years ago, I have practiced in the field of law administered by the Commission and by agencies closely linked to the Commission. It seems to me this morning that all my professional career to date has been a prelude to the responsibilities for which this committee is giving me consideration.

The traditions of the Commission, like those of this committee, are distinguished indeed. If upon the committee's recommendation the U.S. Senate sees fit to bestow its advice and consent to my nomination, I assure you that I shall put forward my very best ef-

forts to continue those traditions and to justify your confidence as well as the gracious remarks of Senator D'Amato and Congresswoman Roukema.

I shall, of course, be pleased to answer any questions, Mr. Chairman, from you or other members of the committee or from personnel from the committee staff.

The CHAIRMAN. Mr. Fleischman, I understand you have your family with you, including your mother and father. Would you like to introduce them to the committee before you proceed?

Mr. FLEISCHMAN. You are very gracious, Mr. Chairman.

My mother is sitting to my left, Mrs. Jean Fleischman. My wife is here to my right, Mrs. Joan Fleischman, and my daughter, Jan Fleischman, and my son, Chuck Fleischman, are just behind me.

The CHAIRMAN. Thank you.

Mr. Fleischman, during your 26 years of practice with Gaston-Snow you've probably had the opportunity to represent many of their clients. Do you intend to limit your participation in Commission proceedings involving all Gaston-Snow clients or only clients of the firm for which you have been a responsible partner?

Mr. FLEISCHMAN. I intend to limit my participation with respect to matters arising before the Commission from any client represented by Gaston-Snow.

The CHAIRMAN. Do you agree to appear before this or any other committee of Congress if so requested?

Mr. FLEISCHMAN. Yes, Mr. Chairman.

ISSUE OF CORPORATE TAKEOVERS

The CHAIRMAN. For the last several years Congress has addressed many issues attendant to corporate takeovers. Some have argued that takeover activity should be severely curtailed, while others, including members of the Commission, have taken a more laissez faire attitude toward takeover activity.

Do you believe that the Williams Act needs any modification? If so, does that act need fine-tuning or major overhaul?

Mr. FLEISCHMAN. Your very first question, Mr. Chairman, goes to what is probably the most contentious issue presently in the financial world.

In the course of practice I have represented nearly all of the participants in takeover transactions at one time or another and, of course, I've been a security holder in corporations. I do seek to remain current on the literature concerning policy issues as well as the techniques that lawyers and investment bankers devise and that corporations devise in these transactions.

I must say I am much impressed by the work of the Office of Chief Economist at the Securities and Exchange Commission seeking to replace anecdotal evidence, so-called, with economic studies of empirically measurable consequences of these transactions taken in the aggregate.

While I have impressions myself, testing points, perhaps, for analysis, I haven't reached conclusions on your question directly or on other questions in the takeover field. I have been given an invitation by Chairman Shad to attend an open meeting of the Commission on November 26, that will commence a review of the issues

involved in your question and that, of course, will be the beginning on my part of the analytical process in earnest by which I can reach an answer to your question. I really don't have one this morning.

The CHAIRMAN. At present the term tender offer is neither defined by statute or by SEC regulation. Do you think such a definition is needed?

Mr. FLEISCHMAN. Needed, Mr. Chairman, may be too strong a word. I think one might very well be desirable. The courts have sought to carve a definition. It may be that the Commission will find, after the review that it is about to undertake, that a definition put out under the rulemaking process would be more desirable.

The CHAIRMAN. Have State legislatures and courts done an adequate job of regulating takeover tactics and defensive schemes?

Mr. FLEISCHMAN. Lawyers and investment bankers, as you know, Mr. Chairman, are not only learned but are ingenious. Courts and State legislatures in the nature of things react. The job that has been done to date I think has been adequate. There is more that can be done at the State level to experiment within our Federal system. There are preemption questions. It would be very difficult to answer your question in a general way.

Being a lawyer, I am particularly delighted that the courts of the several States as well as the Federal courts have reacted in what seems to me to be a responsible way to various developments in the takeover area.

The CHAIRMAN. When you use the term "adequate," it reminds me of a hearing several years ago not before this committee but during an Armed Services Committee concerning the verification aspects of the SALT II Treaty, and the witness involved when asked if he thought that verification was all right in the treaty said that he believed that it was adequate. One of my colleagues asked him to define adequate and when he could not very well he said, "Well, let me just put it to you this way then. Would you be satisfied if your wife were adequately faithful?"

So I understand your answer. I'm never sure that I understand what adequate means, but I won't press you on that today.

REGULATION OF THE GOVERNMENT SECURITIES MARKET

One of the issues that this committee has recently addressed is the regulation of the Government securities market. The SEC has stated its position on this subject this past summer.

Without discussing the specifics of the SEC proposals or other legislative approaches, do you believe that Federal regulation of these markets is necessary?

Mr. FLEISCHMAN. I find it difficult to conclude, Mr. Chairman, that regulation is necessary; but given the bill passed by the House of Representatives and what I understand to be the substance of the bills either under consideration or to be under consideration by the Senate, it does seem to me personally that the Board of Governors is the appropriate locus of principal responsibility if the Congress decides that regulation is to follow.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Mr. Fleischman, I am pleased to join with my colleagues in welcoming you before the committee.

How long is it your intention to serve on this Commission?

Mr. FLEISCHMAN. The full term for which you are considering my nomination, Senator Sarbanes.

Senator SARBANES. So that would be until June 1987?

Mr. FLEISCHMAN. That is correct, sir.

Senator SARBANES. And would it also be your intention, if you were to be renominated, to serve another full 5-year term?

Mr. FLEISCHMAN. I have not addressed the question, Mr. Sarbanes, as to whether the President would consider my renomination. It's a bit away.

Senator SARBANES. Well, let me probe that a little further. If the President, since it would still be the same President at that time—if the President were to nominate you for another term—in other words, for a full term—what would be your current view of that in terms of your willingness to do that?

Mr. FLEISCHMAN. A full term would carry through to 1992, Senator. I have not looked that far forward.

Senator SARBANES. But it is your present intention to serve through this term in any event?

Mr. FLEISCHMAN. Yes, Senator Sarbanes.

Senator SARBANES. And you have not decided in your own mind whether you would want to stay on the Commission beyond that, if the nomination were forthcoming?

Mr. FLEISCHMAN. That is correct, Senator.

Senator SARBANES. I'm pressing you a little bit because it seems to me it is desirable to have some continuity on the Commission. We've had a lot of short-term members in the recent past and I think the Commission suffers as a consequence.

Mr. FLEISCHMAN. I simply think it presumptuous of me to assume that the President would consider a renomination at that time or that this committee and the Senate would approve such a renomination.

Senator SARBANES. I understand. I'm not trying to push you to answer that. I'm trying to make a point. You do bring a distinguished record to the Commission and there is every reason to expect you will be a distinguished member of the Commission. I just wanted to open up this line of thinking.

Let me ask you, from your perception at least, how this all came about. I wonder if you could enlighten the committee on that, your nomination. How did you come into consideration for this nomination? How did it develop?

Mr. FLEISCHMAN. It is my understanding, but only on stories that have been told to me, Senator Sarbanes, that I had the compliment of several recommendations to senior members of the President's staff sometime during last winter or spring.

Senator SARBANES. From people in the industry, as you understand it?

Mr. FLEISCHMAN. From people at the bar and in the industry, yes, and also from people in, for lack of a better word, corporate America. That is to say, the company side of the field administered by the Securities and Exchange Commission.

Senator SARBANES. What screening process did you then go through to reach this point today? Did you meet with Chairman Shad and members of the Commission?

Mr. FLEISCHMAN. Yes, I did, Senator Sarbanes.

Senator SARBANES. I have no further questions, Mr. Chairman. I wish Mr. Fleischman well in his forthcoming, what I assume is to be his forthcoming tenure on the Commission.

The CHAIRMAN. Thank you, Senator.

Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman.

CONGRESSIONAL INVOLVEMENT WITH SEC

It's nice to see you here today, sir. Let me just ask you a philosophical question but one which we have proposed to us many, many times. There has been so much legislation on this issue. First of all, America is the finest example of free enterprise, where the people participate more than any other country in the world and we are right now besieged by different legislation which, in my opinion, could hurt corporate America by tying down their hands. I do not intend to go into each piece of legislation, but you're aware of them as much as I am, restraining the Securities and Exchange Commission on different transactions.

Just briefly, what is your feeling? Do you think Congress is involved more than they should be or not enough in stock market regulation?

Mr. FLEISCHMAN. Since you pose a philosophical question, Senator Hecht, I trust in answering in a general way I will be responsive.

My understanding of the fundamentals of our system of Government is that the Congress has the virtually unfettered right to make that kind of decision if it seeks to become more engaged or less engaged in any area of activity, if it seeks legislation to regulate to a greater or lesser degree any area of activity like the securities markets.

Markets and market activity are very much like the Colorado River, that, as I recollect, runs down the southeast corner of the State of Nevada. If you seek to dam it, it's going to back up and overflow.

Regulation necessary for the protection of investors is to be carefully considered, carefully constructed to accomplish its end. This Congress and its predecessors have done that over these past 55 years. There's always been a very judicious weighing of the desirability of further regulation with the view in mind, to come back to my analogy, that if you seek to divert the waters in an artificial way they're going to find a way of backing up on you and flooding over you again.

I have no philosophic problem with the present balance that the Congress has struck in regulation.

Senator HECHT. Would you care to comment on different pieces of legislation that the different Members of Congress have before us today, not specifically but just, in respect, to the securities market?

Mr. FLEISCHMAN. I would not, sir, seek to comment on specific legislation unless you would like to point a particular bill for comment.

Senator HECHT. At a later time I definitely will get your opinion but certainly not at your hearing for your nomination.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

Mr. Fleischman, as you know, Attorney General Meese gave a speech before the Federal Bar Association on September 13 of this year in which he questioned the constitutionality of our entire system of independent regulatory agencies.

In that connection, there's a suit pending in the Federal district court. Six title insurance companies have argued that the Federal Trade Commission should be barred from bringing price-fixing charges against them because it has operated unconstitutionally since its creation in 1914.

This article in the New York Times of November 6 further states the Department of Justice is also considering whether to side with the companies if the court decides to resolve the constitutional issue.

Mr. Meese is quoted in this article as saying that there are no quasi or independent this or that in a tripartite system of Government. The body with enforcement powers is part of the executive branch of the Government. And Mr. Meese has gone even farther than that and said we should abandon the idea that there are such things as quasi-legislative or quasi-judicial functions that can be properly delegated to independent agencies.

ROLE OF THE SEC

What's your concept of the role of the SEC as an independent regulatory agency and how does it fit into the charge by the Attorney General?

Mr. FLEISCHMAN. I have great respect for the opinions of the Attorney General as the highest ranking law enforcement officer in this country. I have the privilege of practicing, Senator Proxmire, with an older gentleman who wrote speeches somewhat to the effect that you have just cited to me in the 1936 Presidential election, a fellow with a famous name in American history, Mr. Edward Everett. He was on the losing side of that election.

I had thought that the constitutional question had been resolved in the years immediately following that election and I think even Mr. Everett believed that until it has been raised again not only by the Attorney General but in recent Law Review articles as well. I've seen those articles.

I would be awfully bold to thrust myself into that argument. It's over my head.

The role of the Securities and Exchange Commission as it has historically functioned in these 55 years, has been in the mold of those so-called independent regulatory agencies and it has been independent. The President chooses and proposes nominees to the Senate and in so doing, obviously, influences the policy of the

agency as administered by those nominees, when approved by the Senate over the ensuing years.

The Congress has a direct role, as you well know, not only through these hearings, but through appropriations and through direct legislation.

But once launched, the nominees and the Commission have for all the time that I've been practicing, scrupulously carried out their functions in an independent way, enforcing as best the Commission has been able the statutes that the Congress has passed and the President has signed.

Senator PROXMIRE. Can the Commissioners of the SEC, in your judgment, be ordered to carry out the policies of any administration on pain of removal from office if they do not?

Mr. FLEISCHMAN. I had understood that the pain of removal from office, Senator Proxmire, was a pain administered by the Congress and not by the President.

Senator PROXMIRE. Among the many examples facing the Commission are, first, the rapid internationalization of the securities markets; second, trading and competition problems related to the emergence of new instruments and new trading strategies; third, listing requirements and shareholder approval of provisions; and fourth, the controversy raised by takeover attempts involving publicly traded corporations.

I'd like to get your reactions to what you see as some of the main issues involved in each of these areas and what thoughts you might have regarding how they should be addressed. Let's start with the internationalization of the securities market.

Mr. FLEISCHMAN. Internationalization, in my view, Senator Proxmire, is happening to us. Techniques, by which I mean the simple methods of communication across national boundaries, are carrying with them the ability of participants in markets everywhere to trade in markets outside their own country.

We are seeing the capability of transmitting price information through the electronic data gathering and retrival [EDGAR] system. We're seeing essentially continuous markets developing. Internationalization is an issue that, as you know, the Securities and Exchange Commission has addressed within this year in three separate releases seeking comment as to how it should react, how best the participants in the markets both here and abroad feel that internationalization of the markets may be brought into consonance with our ideas of efficiency in markets, integrity in markets, and the protection of investors.

Senator PROXMIRE. That's very helpful. Now I'd like your comments on trading and competition problems related to the emergence of new instruments and new trading strategies.

Mr. FLEISCHMAN. I am not sure, Senator Proxmire, that I understand the thrust of that question. Trading and competition problems—competition among exchanges? Competition among markets or among participants in markets?

Senator PROXMIRE. Well, related as I say to new instruments, new trading strategies. You touched on that a little bit in touching on the technological changes in these areas, the instantaneous international information, and so forth.

EMERGENCE OF NOVEL SECURITIES

Mr. FLEISCHMAN. We are seeing the emergence of what are called novel securities or novel instruments, whether they be securities or not, by which institutions and individuals may trade in the financial markets. Many of them are risk-shifting instruments. Many of them are denominated secondary instruments.

But my best understanding of the study done jointly by the Securities and Exchange Commission, the Commodities Futures Trading Commission, and the Board of Governors of the Federal Reserve System is that the study concluded that in fact liquidity has not been taken from the markets by the emergence of these new instruments nor has there been a negative impact upon the ability of American business to raise primary capital.

Senator PROXMIRE. Do you see any reason for changing listing requirements for shareholder approval provisions?

Mr. FLEISCHMAN. That matter has been under consideration by the major stock exchanges and the National Association of Securities Dealers particularly this year. I am——

Senator PROXMIRE. Now—I beg your pardon, sir. Go ahead.

Mr. FLEISCHMAN. I don't mean to preempt your next question, Senator Proxmire.

Senator PROXMIRE. Go right ahead.

Mr. FLEISCHMAN. As a lawyer, I have represented many entities, both professionals in the securities markets and companies whose securities are listed, and have never myself been satisfied with the present listing requirements, if you will have it so. So I personally am in favor of change in a number of areas affecting the listing requirements. That comes before the Commission, as I understand it, only upon review of rule changes by the markets themselves.

Senator PROXMIRE. What kind of changes are you in favor of and in what direction?

Mr. FLEISCHMAN. I should like to see more publicity accorded to the interpretations by the several markets of their lengthy rule books. It is difficult to punch against a bag when you're not quite sure where the bag is hanging. It is that kind of articulation and publication of rules administered by the markets which would attract my first attention.

Senator PROXMIRE. In a recent article in the Wall Street Journal the Chairman of the Securities and Exchange Commission, Mr. Shad, is reported to have told Congress that legislation is not needed to make certain open market stock purchases subject to tender offers rules because the agency already has sufficient authority to do so.

The article further states several takeover lawyers characterize Mr. Shad's assertion of regulatory authority as a bold attempt to expand the SEC's influence in the hostile takeover arena and questioned the agency's power to do so.

Harvey Pitt, a partner of Fried, Frank, Harris, Shriver & Jacobson's Washington office, said that, "Given Supreme Court precedents it is not clear that the SEC has the power to define a tender offer as it claimed yesterday."

The American Bar Association, for example, has taken the position that such power belongs to Congress and that legislation is

necessary to accomplish any expansion of tender offer rules to cover open market purchases.

What's your view?

Mr. FLEISCHMAN. I am in complete accord that the Congress has the power. The Congress has delegated a good deal of authority to the Securities and Exchange Commission. Recent cases have indicated that for a variety of reasons the Commission's efforts in litigation to extend regulation to transactions not clearly covered by its rules would not be countenanced by the Federal courts.

I don't understand any of those decisions to have plumbed the outer limit of the Commission's rulemaking authority. I would not differ with the chairman on this question.

Senator PROXMIRE. My time is up, Mr. Chairman.

The CHAIRMAN. Senator Gorton.

Senator GORTON. Mr. Chairman, I noticed that the nominee attended the same law school that I did with roughly the same record. I've considered it very carefully and I do not believe that to be an automatic disqualification for the nomination. [Laughter.]

I don't have any questions.

The CHAIRMAN. Thank you, Senator.

Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman.

Mr. Fleischman, I want to welcome you and your family before the committee this morning and echo the sentiments expressed by our chairman.

My questions have all been answered before my turn came, save one. Let me just ask you this. What percentage of transactions are presently made by institutional investors as opposed to individual investors? Do you have a ballpark figure on that?

Mr. FLEISCHMAN. No, sir, I do not. I believe I have read that on these 100-million-plus share days something in the vicinity of two-thirds of the securities traded are traded for the account of institutions. No one quite is sure what the term "institutions" encompasses and excludes and I do not recollect whether in saying two-thirds I mean two-thirds in value or two-thirds of transactions, which is what you asked me.

I do have the impression from literature available to lawyers that approximately that same percentage, perhaps two-thirds, of the share interests of many major American companies is owned by that loosely defined group of institutions.

SIGNIFICANT INCREASE OF INSTITUTIONAL INVESTORS

Senator SASSER. Well, clearly, I think over a period of time there's been a significant increase in the number of institutional investors as opposed to individual investors.

Do you have a view as to what the reasons might be for the decline in individual participation in the market? Is it public confidence? And would it be cause for concern if there were a decline in the participation of individuals in the market, in your judgment?

Mr. FLEISCHMAN. I do not believe in any sense, Senator Sasser, that there is a decline in public confidence in the capital markets here in the United States.

I would be hesitant to answer anything that implied a decline in public participation. There has been a decline in the percentage of participation, but that, as I understand it, rather results from the growth of institutional participation than from the decline in public participation. I mean by that: public participation in the sense of individuals directly participating.

Obviously, the institutions themselves in many senses are simply aggregates of the moneys of individuals who thereby are participating indirectly.

Senator SASSER. Would you agree that the decline in the percentage of individual participation in the market could be a result of other investment opportunities or investment instruments, such as money market accounts, for example?

The reason I pursue this line of questioning is that I have some concerns about what I perceive to be a relative decline in individual investment in the market and the precipitous increase in institutional investment.

Do you have any ideas for broadening the base of the investing public? Does anything come to mind instantly?

Mr. FLEISCHMAN. The only figures I have seen that measure the investing public as such, Senator Sasser, are those published by the New York Stock Exchange, which I think indicate that something in excess of 30 million Americans participate in the markets. But that, again, is a figure which aggregates both those who participate directly and those who participate through pension funds, mutual funds, et cetera.

Senator SASSER. I have a hunch that figure would be reduced substantially if you peeled off those who participate through institutions as opposed to those who participate individually.

Mr. FLEISCHMAN. While I understand that, I do think that if you took absolute numbers and compared them to the number and dollar amount of individual participation in the capital markets 20 years ago, that you would find there was a rise.

Senator SASSER. But the aggregate of individual moneys in institutional investing does mean, I think we could agree, that fewer people are making the decisions about the investments. That really is the basis of my question, if it should be a cause for concern. I won't pursue this any further at the moment, but I was curious if you shared any of these concerns, and if you had any recommendations for trying to broaden participation in the markets. That's a difficult question to ask a New York lawyer but I thought you might have an answer.

Mr. FLEISCHMAN. It would be my pleasure to pursue the question, Senator Sasser, and seek to justify or contradict the assumption that you make.

Senator SASSER. Thank you.

Thank you, Mr. Chairman.

PROLIFERATION OF RICO CIVIL ACTIONS

The CHAIRMAN. Mr. Fleischman, we have recently witnessed a proliferation of racketeer-influenced corrupt organization [RICO] civil actions brought against many members of the securities industry. These suits and other RICO actions against banks, insurance

companies, accounting firms, and even lawyers have resulted in a lot of legislative proposals that would narrow the scope of the statute's application.

Do you believe that RICO should be amended to limit its application and, if so, what amendments would be appropriate?

Mr. FLEISCHMAN. You started, Mr. Chairman, with a question in a contentious area and you are now back to a question in a contentious area.

I am not a litigating lawyer directly. I am aware of the problems raised for the securities and banking industries as a result of RICO. I am aware of the reading of the most recent Supreme Court cases which, while reversing certain second circuit decisions, did not foreclose the possibility that RICO may yet be interpreted by the courts in a more limited way than it has been to date.

The experience to date of the financial service industries in RICO cases has been that that statute enacted by the Congress has been used to circumvent many of the limitations otherwise placed by Congress in the securities laws and in the banking laws—I suppose—on suits that might otherwise be brought and have therefore been brought under RICO.

I could not respond with any specific recommendations to limit the RICO statute.

The CHAIRMAN. Some of my colleagues have been concerned about the tremendous increase in the issuance of higher yield non-investment grade securities, commonly known as junk bonds that everybody refers to.

Do you believe these securities serve any purpose other than to finance corporate takeovers?

Mr. FLEISCHMAN. They are called junk bonds now, Senator Garn. When I was a young lawyer, they were called speculative bonds for the purpose of financing emerging companies. Cycles change.

Yes, I think that less-than-investment grade debt-financing vehicles do serve a legitimate economic purpose.

The CHAIRMAN. Should limitations be placed on the amount of funds federally insured depository institutions can invest in these securities?

Mr. FLEISCHMAN. I have never considered that question, Senator Garn. The safety and soundness requirements of the bank regulatory authorities, the fiduciary requirements that apply to financial institution trust departments, I have always thought would be administered in a way so as to limit any undue exposure by banking institutions to any kind of speculative investment.

The CHAIRMAN. Well, I would agree with you that there's a use for so-called junk bonds. We had a rash this summer of various and sundry bills trying to do something about them because of all the publicity about the large corporate takeovers, particularly with Mr. Icahn and the other famous people running around making a living for their companies out of these types of activities. There are really three issues and I think using the term "junk bonds" clouds the issue. It sounds bad to begin with, just to talk about junk bonds rather than high-yield securities.

But you've got an issue of whether they are useful at all and, second, the issue of being used in corporate takeovers. So you've

got several different issues to look at. That's why this committee has not rushed ahead to jump into something.

There were some immediate bills for moratoriums—stop it all—without any regard to the issues far larger than just a couple of people running around, and you penalize an entire industry and capital structures for a couple of people who have suddenly both faded into the background at least for a while. Mr. Icahn apparently is going to have to run an airline for a while and find out what it's like to manage something.

Senator Proxmire.

Senator PROXMIRE. I've been very concerned lately about the caliber of the Commission and the quality of the people appointed to the Commission and I'm very encouraged by your appointment. You obviously have exactly the right kind of background, 26 years as a lawyer engaged in the practice of securities law. You know securities law. You know the problems connected with securities law. In fact, I understand you teach securities law in the New York University Law School. You lectured at continuing legal education seminars sponsored by Practicing Law Institute.

So I think this is an excellent appointment and I'm delighted to see that President Reagan has selected you. I think it's one of the best appointments I've seen to the SEC.

I'd like to pursue a little further the questioning by Senator Sasser, however, with respect to the small investor.

POSSIBLE INADEQUATE STAFF AT SEC

Recently I read an article in the Sunday New York Times which was entitled, "A Deck Stacked Against Small Investors." One of the points made was that the Commission is receiving more referrals of securities law violations than they have the staff to handle.

Specifically taking insider cases alone, the article points out that:

> Each year the big board refers approximately 50 cases that a spokesman described as fully documented to the SEC for possible action. The American Stock Exchange refers a similar number. The Chicago, Pacific & Philadelphia Options Exchanges also alert the agency to suspicious activities in more than 100 such cases. From the flow of complaints plus its own monitoring activity and other sources, the SEC in the fiscal year 1985 ended September 30 brought only 20 cases.

Now what do you think should be done to ensure that fully documented cases are appropriately handled?

Mr. FLEISCHMAN. I have confidence, Senator Proxmire, that fully documented cases—not necessarily those that the exchanges and their staffs consider fully documented but those that the Division of Enforcement does consider fully documented—are in fact followed up on in each instance.

Full documentation does not necessarily entail prosecution. There are many issues that have to be considered by the Commission's Division of Enforcement and then have to be, in a sense, reconsidered by the Commission before a case is actually brought.

It is extraordinarily difficult for anybody on the outside, like myself, to respond to questions that assume knowledge of the internal processes of the Securities and Exchange Commission or any division of the Commission.

But overall, it is my understanding that productivity has increased and that, with the initiation on a pilot basis of electronic data gathering and retrieval, the ability of the Commission's staff further to increase review will continue to grow.

Senator PROXMIRE. You would apply that answer, I take it, not only to corporate filings but also to the allegations of churning and to the charge that individual investors are not getting the kind of disclosure or the kind of full information which is right at the heart of the SEC's function?

Mr. FLEISCHMAN. I would disagree with the latter of those two allegations. I have not myself seen any evidence of any deterioration in the quality of disclosure. If anything, from the point of view of a lawyer to the securities industry, there has been an increase in the responsible participation by securities firms in seeing to it that appropriate disclosure is conveyed to ultimate customer-participants in the securities markets.

The churning issue I have seen highlighted in perhaps the same articles as those to which you refer. It's a particular but a very narrow issue. My understanding of the position of the Division of Enforcement today is that, when possible, cases of that nature which involve a single registered representative and a very narrowly circumscribed group of public participants are better dealt with by the stock exchanges and the NASD, and I must say I subscribe to that view.

Senator PROXMIRE. Now the question I had with respect to disclosure was directed not to institutional investors who by and large are far better qualified to seek out the information they need, but individual investors. Senator Sasser asked about that to some extent.

But it's your view, as I take it, judging by your answer to the question that the disclosure is adequate for both individual investors and for institutional investors?

Mr. FLEISCHMAN. Yes, Senator Proxmire. Both you and Senator Garn have asked me questions raising the questions in terms of adequate and I realize, as Senator Garn pointed out to me, that in responding in the same terms I open myself up to the question of what adequate really means.

Senator PROXMIRE. Now at a time when the securities industry is undergoing a period of explosive expansion, professional accounting and legal staff has been shrinking of the SEC. According to a 1985 GAO report, General Accounting Office study:

> Securities laws violations are directly proportional to the size and activity of the financial markets. At the same time, however, reports indicate that investor complaints and inquiries to the SEC about mutual funds, about issuers of securities and broker-dealers have doubled in the past 5 years to 30,000 annually.

How concerned are you about the disparity between our growing markets and the shrinking SEC work force?

Mr. FLEISCHMAN. Questions of staffing particularly affecting the Division of Enforcement, by whatever name, have been questions that I have heard raised almost since I first came to the bar.

Again, with deference, it is extraordinarily difficult for someone on the outside to address that question and give any kind of fulsome answer. No practitioner who has represented persons who are being investigated or prosecuted by the SEC has ever found the Di-

vision of Enforcement to lack means or staff. Until my position changes by virtue of this committee's recommendation and the Senate's consent, I could not give you a good answer to that question.

Senator PROXMIRE. Doesn't it seem logical that in view of the explosive activity in the market that it doesn't make sense for the SEC staff to shrink, or can you handle this with improved technology so that productivity is so much greater for the SEC that they can do it with a smaller staff?

Mr. FLEISCHMAN. One has at least hopes, if not expectations, that improved technologies, improved productivity, and improved responsibility on the part of the self-regulatory organizations all contribute to being able to handle such increase in investor complaints as you do find.

SLOW REACTION TO QUESTIONABLE PRACTICES

Senator PROXMIRE. Another recent criticism of the SEC is that it's been slow in reacting to persistent questionable practices by stock brokers, the *Hutton* case being but one highly publicized example.

Would you, as a Commissioner, have any problem recommending prompt action against brokerage houses or any other organizations or corporations where you felt they may have violated the law?

Mr. FLEISCHMAN. No, sir.

Senator PROXMIRE. I have other questions, Mr. Chairman, for the record, but as I said earlier, I think we are very fortunate in having an outstanding appointment by President Reagan and I will enthusiastically support Mr. Fleischman for the SEC as an SEC Commissioner.

Mr. FLEISCHMAN. Thank you, sir.

The CHAIRMAN. Thank you, Senator Proxmire.

Mr. Fleischman, you are an excellent nominee. I am sure you will have no difficulty with this committee or on the Senate floor and we will pursue your nomination as rapidly as our rules will allow us to do so. Not only are you well qualified for this position, I like your hairline, too. [Laughter.]

Do you have anything you wish to say in conclusion?

Mr. FLEISCHMAN. Thank you, sir. I thank the committee for its time.

Senator PROXMIRE. Before you go, is that good-looking group that's sitting right over your right shoulder, is that your family?

Mr. FLEISCHMAN. I think so, sir, but some of that good-looking group, without looking over my right shoulder, I think comes from the staff of the Securities and Exchange Commission.

Senator PROXMIRE. That's a very handsome family. Congratulations.

Mr. FLEISCHMAN. Thank you, sir.

The CHAIRMAN. Thank you.

The committee is adjourned.

[Whereupon, at 10:30 a.m., the hearing was adjourned.]

[Biographical sketch of nominee follows:]

[Response to written questions of Senators Heinz, Mattingly, Proxmire, and Dixon follow:]

I don't think I can give you a better answer than that at this time. Perhaps I would be able to after having functioned as a Commissioner for some time.

Senator PROXMIRE. Well, I hope you will look into it. You certainly, as I say, have just the right kind of background to give you the capability of inquiring with real competence.

Commissioners Cox and Peters have been reported as favoring more stringent enforcement powers in certain areas.

Do you think the Commission and the self-regulatory organizations should be provided with greater enforcement tools?

Mr. FLEISCHMAN. In my practice, Senator Proxmire, I have never found either the Commission or the so-called self-regulatory agencies to lack enforcement tools.

Senator PROXMIRE. How about giving the SEC the power to exact fines?

Mr. FLEISCHMAN. I have heard that mentioned and I do not react either positively or negatively to that. I simply want to know more.

Senator PROXMIRE. Will you let us know after you've been with the Commission a month or so if you've changed your mind on that if you have any further thoughts on whether or not fines might be helpful?

Mr. FLEISCHMAN. It would be my pleasure to do so, Senator Proxmire.

Senator PROXMIRE. Do you have any other recommendations that should be considered to buttress the enforcement authority of the Commission?

Mr. FLEISCHMAN. I do not come with an agenda of recommendations, Senator Proxmire. No, I do not.

Senator PROXMIRE. Now recent criticisms of the SEC include the following: first, only a small fraction of the corporate filings required by law are ever given a thorough investigation. Second, churning—that is, the excessive trading of individual accounts by brokers to generate commissions—is more widespread than ever before. Third, individual investors are more exposed to questionable investments but are getting less information to evaluate them. Fourth, the SEC is critically underbudgeted and understaffed.

Let me ask you how you plan to address these problems. First, only a small fraction of the corporate filings required by law are ever given a thorough examination.

Mr. FLEISCHMAN. I shall be one Commissioner of five, with administrative responsibility primarily in the Chairman. In terms of responding to you on how I will address these problems, therefore, I know you understand that I am responding in how I will evidence my interest in these problems.

The staff of the Division of Corporation Finance has over the years addressed unceasing efforts to the review of corporate filings. My understanding from the outside is that productivity, however it is measured in that area, has been continually increasing in that division.

Obviously, when there is a flood tide, as there is every several years, of new public offerings, the capability of this Division of Corporation Finance to review the filings by previously public companies has to be impacted by the diversion of resources to process the initial public offerings.

CERTIFICATION OF THE GENERAL COUNSEL OF THE SECURITIES AND EXCHANGE COMMISSION CONCERNING THE FINANCIAL HOLDINGS OF EDWARD H. FLEISCHMAN, NOMINEE FOR MEMBER OF THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

I hereby certify that I have examined statements of the holdings of Edward H. Fleischman and his wife Joan Walden Fleischman, as submitted by him to the United States Senate Committee on Banking, Housing, and Urban Affairs.

I have reviewed those statements, together with underlying documentation furnished to me by Mr. Fleischman, pursuant to the requirements of Rule 5 of the Securities and Exchange Commission's Conduct Regulation, 17 CFR 200.735-5, and I certify that I found nothing in said statements which does not fully comply with the requirements of that Rule.

I further certify that my examination was also conducted to take into account the requirements of the Canons of Ethics for Members of the Securities and Exchange Commission, 17 CFR 200.50, et seq., and particularly Section 60 relating to possible disqualification in particular matters, and the requirements of Executive Order No. 11222, as amended (3 CFR, Jan. 1973, Rev., Chapter IV, pages 160ff), and particularly Part IV thereof relating to Presidential appointees, and I found nothing in said statements which does not fully comply with the requirements of the Canons and Executive Order.

Daniel L. Goelzer

DANIEL L. GOELZER
General Counsel
Securities and Exchange Commission
Washington, D.C. 20549
(202) 272-3171

Dated: October 30, 1985

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Fleischman (LAST) Edward (FIRST) Hirsh (OTHER)

Position to which nominated: Commissioner, Securities & Exchange Commission Date of nomination: October 17, 1985

Date of birth: 25 (DAY) June (MONTH) 1932 (YEAR) Place of birth: Cambridge, Massachusetts

Marital status: Married Full name of spouse: Joan Barbara Walden Fleischman

Name and ages of children: Charles Mark Fleischman, 27

Janet Sarah Fleischman, 25

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Harvard College	1949-52; 1956	B.A.	March 1957
Columbia Univ. Law Sch.	1956-59	LL.B.	June 1959

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

College: B.A. cum laude

Law School: Stone Scholar

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
American Law Institute		1976 to date
Amer. College of Investment Counsel		1982 to date
American Bar Association	chairman of various subcommittees	1965 to date
Harvard Alumni Association		1960 to date
Columbia Law School Alumni Ass'n.		1960 to date
Society of the Valley Hospital		1975 to date

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

7/59 to date	Beekman & Bogue (since 5/81: Gaston Snow Beekman & Bogue) NYC, NY	partner (from 1/68); previously associate lawyer
2/59 - 5/59	Stechert-Hafner Inc. NYC, NY	part-time clerk
8/58 - 1/59	Walter J. Johnson Co.Inc. NYC, NY	part-time clerk
6/58 - 8/58	Kraus Periodicals Inc. Mamaroneck, NY	clerk
9/57 - 5/58	Walter J. Johnson Co.Inc. NYC, NY	part-time clerk
7/57 - 8/57	Mass.Dept.of Public Works East Cambridge, MA	maintenance work
6/57 - 7/57	Cable Raincoat Co. So. Boston, MA	general shop work
1/56 - 6/57		full-time student
12/52 - 12/55	U.S. Army Monterey, CA and Nuernberg, W. Germany	Russian translator; clerk
9/52 - 12/52	American Chemical Co. Boston, MA	general shop work

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

None

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

Co-draftsman: Amer.Bar Ass'n. Model Simplified Indenture (published in Business Lawyer 2/83)

Amer. Bar Ass'n. committee paper on resale of institutional privately-placed debt (published in Business Lawyer 7/79)

Amer.Bar Ass'n. committee letter on utilization and dissemination of "inside" information (published in Securities Regulation Law Journal 1974)

Co-author: Series of articles on SEC Rule 144 (published in New York Law Journal 1973-76)

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Registered Republican

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

None

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

See attached page A.

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

Yes, except for fixed sums payable to me by the firm.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

no

3. Has anybody made you a commitment to a job after you leave government?

no

4. Do you expect to serve the full term for which you have been appointed?

yes

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None, except for arrangements relating to withdrawal from law firm (reflected in the attached financial statement) and continuing work on American Bar Association committee projects.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

See attached page B.

3. Describe any business relationship, dealing or financial transaction (other than tax-paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

My law practice has consisted in large part of representation of persons and firms regulated by, or subject to the laws administered by, the Securities & Exchange Commission.

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

See attached page C.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None, except a suit against all partners of the former Beekman & Bogue law firm brought circa 1980 in Supreme Court for New York County by a former partner. Settled without personal payment circa 1982.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

Page A

I have spent the past 26 years as a lawyer engaged in the practice of securities law, representing clients in connection with securities registrations, proxy solicitations, corporate acquisitions and divestitures, tender offers, private placements, venture capital investments, employee incentive and benefit plans, trust indentures, corporation and partnership matters, and stock exchange listings. That practice has included acting as counsel to listed, O-T-C and private corporations, purchasers of venture capital securities, public underwriters, indenture trustees, institutional lenders, NYSE (national) and NASD broker-dealers, futures commission merchants, investment advisers, commodity trading advisers, commodity pool operators, registered investment companies and investment company affiliates.

In connection with my law practice, I have been able to participate in a variety of committee work for the American Bar Association, to teach securities law at New York University Law School, and to lecture at continuing legal education seminars sponsored by Practising Law Institute, ALI/ABA and Law & Business, Inc., among others.

Page B

All investments and liabilities are reflected in the attached financial statement. Similarly, clients which my law firm has represented generally and substantially, and as to which I have been the responsible partner, are identified in the attached financial statement.

If confirmed, I intend to resign as a partner of Gaston Snow & Ely Bartlett (Gaston Snow Beekman & Bogue in New York City). In addition, as a Commissioner, I intend to disqualify and recuse myself from matters before the Commission in the nature of a request on behalf of a specific party for an exemption from a rule or statute of general applicability, or matters involving the institution of enforcement proceedings, under the following circumstances:

(a) where Gaston Snow represents any party involved in any such matter, except where the representation is unrelated to the matter pending before the Commission, or

(b) where I had any connection or gained significant knowledge while I was at Gaston Snow, or

(c) where certain entities which Gaston Snow has represented generally and substantially, and as to which I have been the responsible Gaston Snow partner (such clients being identified in the attached financial statement), are involved in any such matter.

In view of certain interests which may be deemed "financial interests" in Gaston Snow pursuant to 18 U.S.C. 208(a), I intend to seek a waiver from John S. R. Shad, Chairman of the Commission, pursuant to 18 U.S.C. 208(b), to allow me to participate in general policy-making decisions, making of legislative recommendations, other legislative matters and general rulemaking decisions, which may have a direct and predictable effect on Gaston Snow clients so long as that effect is not disproportionate to the effect of the action on all similarly-situated entities.

In addition, I intend to disqualify and recuse myself, on a case-by-case basis, with respect to any matter, where, in order to avoid the possible appearance of impropriety, it appears desirable to me to disqualify myself, despite the lack of any actual conflict of interest. In general, it is not my intention to recuse myself from general policy considerations or rulemaking proceedings.

SUPPLEMENTAL WRITTEN QUESTIONS

SUBMITTED BY

MEMBERS OF THE

SENATE COMMITTEE ON

BANKING, HOUSING & URBAN AFFAIRS

* * * * *

RESPONSES OF

EDWARD H. FLEISCHMAN

QUESTIONS BY

SENATOR HEINZ

Question 1. I have been approached by many groups who have asked me to support comprehensive legislation affecting takeover law. I have been approached by many others who argue that takeover law is the responsibility of the states and the federal government should stay out of it. In light of the fact that state laws on this subject have been struck down repeatedly as unconstitutional, do you agree that if action is to be taken, it must be taken by the federal government -- that state governments cannot effectively act in this area?

Question 2. The SEC has been criticized lately both for interfering in states' business and for not interfering with states' business when it comes to hostile takeovers. For example, in the Household case, the SEC submitted a friend of the court brief to the Delaware court. Do you think it is the SEC's position to take a position in a case pending before a state court?

Question 3. Furthermore, the SEC has proposed a rule requiring equal treatment of all shareholders. As you know, it was issued in response to the Delaware Court decision in Unocal. Do you think the SEC should issue rules to overturn state court decisions?

Response to Questions 1, 2 and 3. Questions of federal-state relationships under the federal securities laws are not confined to the takeover area, and Senator Heinz' questions, while arising out of the takeover context, are not limited to that context. Certainly there are occasions when it is appropriate for the S.E.C. to set forth its views as amicus to state courts or even to adopt rules whose effect is to overturn state court decisions. Those occasions may be infrequent, and should be chosen with care, but, for example, in matters arising under the 1933 Act as to which the state courts have concurrent jurisdiction, response to a particular state court proceeding could be necessary to the S.E.C.'s overall administration of the Act.

The takeover context presents particular problems, raising questions of deeper federal intrusion into corporate governance than has been the pattern or practice to date. I stated at the Committee's hearing upon my nomination that, while bearing in mind the constitutional issues, I

think there may be more that can be done by the states to experiment within our federal system. How or whether one or more states should take legitimate action remains to be seen, but I would not yet conclude that the only effective governmental response to takeovers (if such a response is necessary) must come from the federal government.

Question 4. (If you are in general agreement with the SEC proposed rule) The Court in the Unocal case disallowed equal treatment of the acquiring group on the grounds that they were proven greenmailers. What restraints or sanctions -- by rule or regulation -- do you believe should be imposed on greenmailers instead?

Question 5. Do you believe that our nation is negatively affected in any way by the current spate of hostile takeovers?

Question 6. What are your thoughts on the "leveraging of corporate America" that has resulted from these takeover battles?

Question 7. Do you think action should be taken by Congress to slow down the takeover process? Why or why not?

Response to Questions 4, 5, 6 and 7. At the Committee hearing, I responded to Chairman Garn that, while I have preliminary reactions on takeover issues, or what I described as "testing points...for analysis," I have not yet reached conclusions that would enable me to respond directly to Senator Heinz' questions in this area. Since the Committee hearing, I have attended the public Forum on takeover issues held by the S.E.C. on November 26th and have begun the process of grappling with these issues.

With respect to the two questions that are more narrowly focussed, it seems appropriate to draw attention to occurrences in the period since the Committee hearing. First, relevant to "greenmail", there appeared to be a consensus at the S.E.C.'s public Forum that to a great extent "greenmail" was a phenomenon for which the capital markets had self-corrected; that is: the market consequences had become adverse, so the greenmail demand itself had engendered its own rejection. Second, relevant to "leveraging", Mr. Volcker was

quoted in the newspapers on the subject of excessive "leveraging" by companies within and without the takeover context, while on the same day The New York Times recounted the large dollar amount devoted by clients of one leveraged buy-out specialist to reduction of buyout-related debt. These two conflicting items evoke a repetition of a response I made to Chairman Garn: I am much impressed by the work of the S.E.C.'s Office of Chief Economist in seeking to replace anecdotal evidence with economic studies of empirically measurable consequences of aggregates of takeover-related transactions.

Question 8. I have heard complaints that the SEC is shirking its duty when it comes to hostile takeovers. Stock manipulation by bidders has been alleged. Stories abound of possible insider trading in stocks of companies that later become targets in hostile takeovers. Claims are made that 13D filings reveal only boilerplate rather than real disclosure language. Is the SEC doing its enforcement job? Do you think the SEC needs to be more active or more diligent in policing hostile takeovers?

Question 9. Does the SEC have adequate staff to do the job that needs to be done?

Response to Questions 8 and 9. So far as can be determined by an outsider, the Enforcement Division of the S.E.C. is doing its job in the takeover area actively, diligently and effectively. I agree that stories abound; I've heard them myself, but I've heard of no instance for which anything like the proof that we would require of a governmental enforcement agency was supposed to be near at hand. Market activities proceed from a wide variety of sources and motivations, and the S.E.C. and the self-regulatory organizations are quite effective in isolating and pursuing those activities that are legally impermissible.

Question 10. Questions have been raised about the conflict of interest in a leveraged buyout when management with superior information buys out a company from its shareholders and then, within a relatively short period, turns around and takes the company public at a significant profit to itself. Do you believe a conflict of interest exists in this

case? Do you have any concerns about this practice? Do you have any problems with respect to the numerous leveraged buyouts that have recently occurred?

Response to Question 10. Concerns are naturally raised when management deals on its own behalf with successive shareholder groups, but both state and federal courts have articulated substantive standards, and the S.E.C. and federal courts have developed disclosure standards, for these successive transactions. As a result, the conflicts inherent in leveraged buyouts, and equally inherent in initial public offerings, have been substantially reduced and have been subjected to the scrutiny that arises out of public disclosure. Not every transaction is letter-perfect, but I am not uncomfortable with the present procedures.

Question 11. Are there any areas of the securities laws where you think legislative improvements can and should be made and, if so, what are they?

Response to Question 11. No doubt there are provisions of the federal securities laws where legislative improvements can be made, and, if confirmed, I shall remain alert to the desirability of such improvements. I do not, however, carry a list of such legislative proposals. The substantial rulemaking authority conferred on the S.E.C. under the statutes it administers has generally been sufficient to effect the administrative and substantive improvements decided upon by successive Commissions.

Question 12. There is some concern about the use of the EDGAR system which will store all SEC documents in electronic files rather than paper files. Do you support this move? Should there be a paper file as well as an electronic file at least until we are sure the new system is safe, sound and does the job adequately?

Response to Question 12. I wholeheartedly support the EDGAR project. It is my understanding that, as the S.E.C. moves forward with the EDGAR operational system, paper is to be used until the S.E.C. is satisfied that the system is safe and sound and does its job adequately. In any event, microfiche of electronic filings is prepared on a daily basis, and paper copies of the filings may be obtained from the microfiches.

QUESTIONS BY

SENATOR MATTINGLY

Question 1. During the last couple of years we have witnessed a number of hostile corporate takeovers. What legislation, if any, is needed to deal with the situation?

Response to Question 1. At the Committee's hearing upon my nomination, I responded to Chairman Garn that, while I have preliminary reactions on takeover issues, or what I described as "testing points...for analysis," I have not yet reached conclusions that would enable me to respond directly to Senator Mattingly's question in this area. Since the Committee hearing, I have attended the public Forum on takeover issues held by the S.E.C. on November 26th and have begun the process of grappling with these issues.

Question 2. Legislation has been introduced to prohibit the trading on certain exchanges and markets of non-voting shares and shares carrying disproportionate rights. What is your opinion of that legislation?

Response to Question 2. The proposed legislation intended to prohibit the trading of particular varieties of securities on particular markets, as I understand it, seems to fail of one of its principal objectives, since the public trading of existing securities would nonetheless continue (although in less prominent markets) and the public purchasers and sellers would merely be deprived of a measure of market surveillance and protection. Further, there are publicly-traded securities (limited partnership interests, for example) that are the equivalent of non-voting shares in corporate enterprises but are not susceptible of being endowed with an ordinary voting right.

The principal exchanges and the NASD are exploring voting rights issues and their implications, with the participation of public company representatives. It seems to me that the initiative in this matter should best emanate from those who govern the markets and those who compete for investors' funds.

QUESTIONS BY

SENATOR PROXMIRE

Question 1. Market Structure. A number of market structure issues have been commonly identified as ones that should continue to be addressed and reviewed by the Commission. These include: 1) options trading on over-the-counter stocks, including multiple trading and side-by-side trading; and 2) unlisted trading privileges in over-the-counter shares. What are some of the main issues you think have to be resolved in each of these areas?

Response to Question 1. The capacity of marketmakers, trading stocks alongside options on those stocks, to exploit the advantages that accrue from side-by-side trading has been an issue of persistent concern. The S.E.C. reflected that concern in the analysis and discussion included in its OTC Options Release last spring and in its careful conditioning of side-by-side trading upon substantial trading volume in the underlying stock dispersed among numerous marketmakers. Similarly, with respect to unlisted trading privileges, the possibility of adverse effect on markets for stocks traded both over-the-counter and pursuant to unlisted privileges on exchanges, arising out of market fragmentation and investor confusion, has been an issue of persistent concern. That concern was reflected in the S.E.C.'s Unlisted Trading Privileges Release this past autumn.

While confirmation of the positions taken by the S.E.C. waits upon actual experience, in both instances I find its analyses thorough and its conclusions for the time being persuasive.

Question 2. Markets. This Commission has, for the most part, encouraged competition between exchanges and the over-the-counter market. Where do you think this competition is taking us and how do you see U. S. trading systems evolving in the future?

Question 3. Effects of Technology on the Securities Industry. What effects do you think technology and telecommunications innovations are having on the trading of financial instruments and how, if at all, do you think this will affect our exchanges and trading sytems in the future and the move toward a more global or international trading system?

Response to Questions 2 and 3. Competitiveness between domestic exchanges and the over-the-counter markets is only a sub-set of the multi-dimensional competition that characterizes capital markets today. International competition, competition among purveyors of financial services, and competition between investment instruments and risk-shifting instruments, as well as competition among domestic markets, are simultaneously proceeding and interacting. The concerns of a decade ago as to the very survival of auction or dealer markets, therefore, appear today in a different perspective.

Technological advances, particularly innovations in telecommunications, have fueled this increase in competition despite territorial borders, prior legislative barriers and functional divisions. Recently, for example, a two-way linkage for transmitting bid and asked prices generated by members of the Stock Exchange (London) and the NASD was formally announced, and certain domestic exchanges were reported to be working on similar links with other markets abroad; and The Wall Street Journal has featured a report on computer transmission of orders from customers to their brokers and from brokerage offices to the trading floors. Thus far, the resulting intermarket competition appears to have been beneficial, adding liquidity, spreading systematic risk, and provoking both auction and dealer markets here in the United States to develop mechanisms attractive to increasingly sophisticated market participants.

Question 4. Internationalization of the Securities Markets. I would like more detail as to what you see as some of the key issues involved in the growing internationalization of our securities markets and trading systems and what you think should be the role of the Commission and the private sector in addressing those issues.

One of the major issues I gather that needs to be addressed and resolved in this area involves the clearance and settlement of securities traded in the international arena. What do you believe should be the role of the Commission, if any, in addressing this issue and what are your thoughts on the most responsible way to deal with it?

Response to Question 4. The S.E.C. has been addressing internationalization issues, both as to multinational distributions of securities and as to transnational trading in securities, via a series of concept releases seeking to elicit comments and discussion by interested persons on both sides of the Atlantic and Pacific Oceans. In addition, the Director of the S.E.C.'s Enforcement Division has recently spoken about the S.E.C.'s assistance in bilateral negotiations looking to international protocols in the enforcement arena. I think both these roles are particularly appropriate for the Commission. The private sector, for its part, seems determined to stay several steps ahead of the S.E.C. -- again appropriately, in my view -- in precipitating the development of continuous markets and thereby in posing additional regulatory challenges.

Given the crucial role that clearance and settlement safeguards play in investor protection and in protection of the marketplace itself, I am encouraged that the S.E.C. has been presented with a variety of transnational intermarket linkages involving different mechanisms for clearing and settling stock and options transactions. Most recently, the Options Clearing Corporation proposed amendments of its rules with a view to linkage for currency options with the Stock Exchange (London). Whether the preferred mechanism is determined to be an "associate clearinghouse" (as proposed by the O.C.C.) or a safety net of cross-agreements backed by letters of credit (such as those accepted by the Commodity Futures Trading Commission for purposes of the Chicago-Singapore linkage) or something still different, ultimately, as I stated to Senator Proxmire at the Committee hearing, the consequences of internationalization must be consonant with the concepts of market efficiency, market integrity and investor protection that underlie our domestic capital market structure.

Question 5. Intermarket Surveillance Group. Do you believe that the Intermarket Surveillance Group, as presently constituted, provides a sufficient means for the self-regulatory organizations to share relevant surveillance data

among themselves and the SEC or do you agree with at least one of the self-regulatory organizations that "fundamental weaknesses exist"?

Response to Question 5. Yes, I believe that the present Intermarket Surveillance Group provides sufficient means for the sharing of relevant surveillance data among its members and with the S.E.C., but that is not to say that I.S.G. is a perfect or near-perfect vehicle. The cost/benefit balance presently struck by I.S.G. requires periodic review, and the continued evolution of market techniques perforce elicits revision or replacement of prior surveillance mechanisms.

Question 6. Exporting Capitalism. A recent Wall Street Journal article reported that, "With U.S. and European commercial banks reluctant to lend new funds in developing countries, some see fresh foreign investment in Third World stock markets as a way to ease the global debt crisis." According to Peter Vermiyle, former chief investment officer at Citicorp, "That's really the ultimate solution: to finance growth in these countries with equity rather than debt." And John Templeton sees global investing not only as a solution to the Third World's debt crisis, but also as a step toward world peace. "The more international investing we have, the more we understand each other," he says. Following up on these observations, how active do you think the SEC and the United States government should be in attempting to export our capital markets and capital formation mechanisms abroad and what types of technical assistance do you think we should be providing other countries in order to assist them in developing their capital markets? What specific role, if any, do you think the SEC should play in this endeavor?

Response to Question 6. The strength of our capital markets reflects their roots in and their adaptation to the needs of the United States. Similarly, the strength of our statutory framework for fostering capital formation, protecting investors and maximizing market efficiency, reflects the development of that framework in response to American needs. I believe that the fundamentals of our market and related legal structure -- full disclosure, widespread access to market

information, supply-and-demand pricing, freedom from manipulative devices, and marketmaker responsibility, among others -- are "exportable", and that the S.E.C. can well make available to developing countries (as I understand individual Commissioners have done in the past) the lessons in basic principles that we in the United States have learned over many decades. I don't believe, however, that our market structure or our legal framework is the complete answer to the needs of any other country, industrial or developing. Each must adapt fundamental market notions to its own capital environment.

Question 7. Allegations of Securities Laws Violations. The SEC has taken a strong stance against insider trading and has attempted to crack down on this type of activity. Yet in the May 1985 edition of The American Lawyer in an article entitled "The Roaring Eighties", which chronicles the Phillips Petroleum takeover battle, serious allegations of insider trading were raised regarding Carl Icahn and Ivan Boesky. According to one takeover advisor: "These arbitrageurs and takeover entrepreneurs and people from Drexel are a ring, pure and simple. They feed on their own inside information and cooperation, and to believe anything to the contrary is to be ridiculously naive." I do not want to be accused of being "ridiculously naive." Will you give me your assurance that if confirmed you will review this article and see to it that the SEC thoroughly investigates the allegations that were made regarding the Phillips takeover?

William Safire also wrote an article in The New York Times dated July 8, 1985 relating to Prudential-Bache Securities, Inc. entitled "Soft on Brokers". Will you also review this article and, if confirmed, see to it that these allegations are investigated by the Commission?

Response to Question 7. I can assure Senator Proxmire that I shall review both articles promptly and thoroughly. I can also assure Senator Proxmire that, if that review leads me to conclude there is a real likelihood of securities law violations not already investigated by the S.E.C.'s Division of Enforcement, I shall do my best to convince the other Commissioners to authorize such an investigation.

Question 8. Tender Offers. There have been countless reports that this Commission has a clear-cut bias in favor of the investment banking community over the business community when it comes to the subject of hostile takeovers. The impression we get up here is in fact that there are few if any abuses in the tender offer process. Is this your view or do you approach the tender offer debate with a more open mind? What abuses, if any, have you seen in the tender offer process?

Response to Question 8. At the Committee hearing, I responded to Chairman Garn that, while I have preliminary reactions on takeover issues, or what I described as "testing points...for analysis," I have not yet reached conclusions that would enable me to respond directly to Senator Proxmire's questions in this area. Since the Committee hearing, I have attended the public Forum on takeover issues held by the S.E.C. on November 26th and have begun the process of grappling with these issues.

Question 9. Glass-Steagall. The Administration supports the concept of a one-stop financial shopping center where presumably a consumer could get all of his banking, securities, real estate and insurance needs met under one roof and former Treasury Secretary Regan has testified in the past that he thinks banks should be allowed to underwrite corporate securities. What are your views on Glass-Steagall and do you think banks should be allowed additional securities powers? If not, why not? If so, why?

Response to Question 9. I am of the generation that studied the history of the 1920s and 1930s as immediate past, and I respect the policy decision that resulted in separation of commercial and investment banking. Some but not all of the reasons for that decision seem to me to remain relevant today; some but not all of the "revisionist" analyses of the problems perceived 50 years ago seem to me to be persuasive.

Therefore, while I come to financial service issues with a predilection for open competition within a general framework of "functional regulation", I approach the basic Glass-Steagall division of deposit-taking, on the one hand, and underwriting, distribution and trading of securities, on the other hand, with real concern as to whether particular additional powers, given to either present-day banking community, would substantially increase the danger of having to re-learn the lessons that Glass-Steagall was meant to address.

QUESTION BY

SENATOR DIXON

Question. I am aware of and concerned about the recent SEC staff no-action letter given to Security Pacific National Bank to institute an options trading program for government securities wherein trades might in effect be guaranteed by the bank's capital. Do you feel it is appropriate for the SEC to authorize the creation of the competitive equivalent of a new securities exchange -- a rather major step -- without at least public hearings and Commission review, if not review by the Congress as well?

Response to Question. The flexibility of the S.E.C.'s interpretive and "no action" letter process allows for staff disposition of a myriad of issues, most of which are of parochial concern and do not approach the need for a formal hearing or rulemaking procedure. That process works well 99 44/100% of the time. Where a position taken in staff correspondence affects fundamental statutory concepts or substantive competitive interests, I think it appropriate for the S.E.C. in its discretion to review its staff's position, with public participation if the context makes that desirable. Neither S.E.C. review nor particular procedures should, however, be anticipated as a matter of course in instances not required by the Administrative Procedure Act.

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